

## **Accounting for variation in hospital financial performance under prospective payment**

**ISSUE:** What factors account for the wide variation in hospitals' inpatient PPS margins that we observe annually?

**KEY POINTS:** The attached draft chapter describes the methods, data, and findings from our multivariate analysis of variation in hospital inpatient PPS margins. This analysis has been carried out for MedPAC by Kathleen Dalton, Ph.D. at the Cecil G. Sheps Center for Health Services Research in the University of North Carolina.

The multivariate model accounts for about one-half of the variation in hospitals' inpatient PPS margins:

- Payment variables included in the hospital inpatient PPS account for about one quarter of the PPS margin variation.
  - Most of this variation reflects the role of policy adjustments—as opposed to cost-related factors—such as payments above the estimated cost relationship for the indirect costs medical education, additional payments for hospitals serving a disproportionate share of low-income patients, and special payment provisions for certain rural hospitals.
  - A small portion appears to be attributable to measurement problems affecting certain cost-related payment variables, including the case-mix adjustment, the wage index, and the large urban payment differential.
- An additional 20 percent of margin variation is explained when provider characteristics are added to the model. Most of these (occupancy, length of stay patterns) are at least partially under management control.
- The remaining one half of the variation is unexplained. .

**ACTION:** We would appreciate feedback from the Commission on the content and presentation of this material in the draft chapter.

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